1999

Fred K. Stocks and Brenda K. Stocks v. United States Fidelity and Guaranty Company, and the Talbert Corporation : Brief of Appellee

Utah Court of Appeals

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IN THE UTAH COURT OF APPEALS

FRED K. STOCKS and BRENDA K. STOCKS,	:	
Plaintiffs/Appellants,	:	Case No. 990624-CA
v.	:	
UNITED STATES FIDELITY AND GUARANTY COMPANY, a corporation, and THE TALBERT CORPORATION, a corporation,	:	Oral Argument Priority 15
Defendants/Appellees.	:	

BRIEF OF APPELLEE - THE TALBERT CORPORATION

APPEAL FROM A FINAL JUDGMENT OF THE SEVENTH DISTRICT COURT OF SAN JUAN COUNTY, UTAH
THE HONORABLE BRYCE K. BRYNER

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases Cited:

Statutes and Rules Cited:

Other Authorities Cited:

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JURISDICTION

Appellee The Talbert Corporation (hereinafter "Talbert") does not contest the jurisdiction of the Utah Court of Appeals and admits the Court has jurisdiction under U.C.A. § 78-2a-3(2)(j).

ISSUES AND STANDARD OF REVIEW

1. May shareholders of a corporation bring suit in their individual capacities as shareholders for a wrong allegedly done to their corporation by a third person?

   A. If not, is the shareholders' standing to bring suit enhanced if the shareholders have personally guaranteed the corporate debt?

Standard of Review. Summary Judgment is a matter of law which is reviewed for correctness. Ryan v. Dans Food Stores, 972 P.2d 395, 400 (Utah 1998).

STATEMENT OF CASE

Talbert agrees with Appellants' Statement of Case in paragraphs A and B on page 3 of Appellants' Brief. Talbert disputes the relevancy of the facts set forth in paragraph C of Appellants' Brief.

STATEMENT OF FACTS

1. A forest fire in the Manti-La Sal Mountains, which gives rise to Appellants' claims, occurred on June 14, 1994. Paragraph 11 of the Verified Complaint. (R.5.)[1]

2. Appellants Fred and Brenda Stocks commenced a preemptive lawsuit in the name of their corporation on December 22, 1994 against the landowners, namely the Paul Redd family, to prevent the Redds from terminating a Timber Harvesting Contract with Timber Products, Inc. (the corporation) and against USF&G as the issuer of a commercial general liability insurance policy and Talbert as the independent agent that sold Timber Products, Inc. the policy.

3. In response to Appellants' Complaint, the Redds asserted substantial counterclaims against Timber Products, Inc., the corporation only. The case is entitled

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[1] All references are to the court file (R) with page number.

Timber Products, Inc. v. Paul David Redd, . . . USF&G, The Talbert Corporation, et al. Civil No. 940700057-CV[2] (herein the "Timber Products Case"), pending before the Seventh Judicial District Court in San Juan County, Utah. See Verified Complaint, paragraph 13. (R.5.)

4. Appellants belatedly attempted to assert their individual emotional distress claims in the Timber Products Case but were denied by Order of the Court entered on July 14, 1997. Appellants then appealed the denial of the same claims to the Utah Supreme Court. A Petition for An Interlocutory Appeal was denied by the Supreme Court on September 29, 1997. Appellants then commenced this action on December 12, 1997.

5. In paragraph 17 (R.6) of the Complaint in the present action, Appellants allege that Talbert and USF&G "willfully, maliciously and in bad faith: (a) denied the claims, (b) failed and refused to provide Timber Products with any defense to the claims in the Timber Products Case," the effect of which caused Appellants "loss of peace of mind" and "severe mental and emotional distress." Paragraphs 23 and 31 of Verified Complaint. (R.7, R.9-10.)

6. There is no evidence in the record that Fred and Brenda Stocks personally paid any of the legal expenses to pursue the Timber Products Case, although it is

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[2] This action has not been tried and is still pending in the Seventh Judicial District Court.

undisputed that they have always personally guaranteed the corporate debt to the corporation's financial lenders both before and after the fire.

7. Talbert is not an insurance company and is not an underwriter of the risks, because it issued no policy in its own name.

SUMMARY OF ARGUMENT

Appellants are claiming that they have suffered emotional distress for Talbert's (and USF&G's) failure to provide insurance defense to their corporation in the Timber Products Case. They are seeking a "personal tort remedy"[3] for the alleged breach of contract to procure insurance by the agent Talbert for their corporation.

Under Utah law, a shareholder of a corporation may not bring a suit in his individual capacity as a shareholder for a wrong allegedly done to his corporation by a third person. The fact that Plaintiffs have personally guaranteed the corporate debt to the corporate lenders both before and after the fire does not enhance that lack of standing. No court has recognized a tort remedy to individuals for mental distress for breach of contract between other parties (corporation and agent). Appellants are not named as individual parties in any lawsuit and hence have no claims as "named insureds" against Appellees.

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[3] Intentional or negligent infliction of mental distress.

ARGUMENT

POINT I.

SHAREHOLDERS CANNOT MAINTAIN AN ACTION IN THEIR INDIVIDUAL CAPACITIES AS SHAREHOLDERS FOR WRONGS DONE TO THEIR CORPORATION BY A THIRD PERSON.

Utah law provides that a shareholder may not bring a suit in his individual capacity as a shareholder for a wrong done by a third party to his corporation. Norman v. Murray First Thrift, 596 P.2d 1028, 1031-1032 (Utah 1979); DLB Collection Trust v. Harris, 893 P.2d 593, 596 (Utah Ct. App. 1995). This general rule applies even when a shareholder owns all or practically all of the stock of the corporation. In Norman, the Utah Supreme Court held that the sole shareholder of a corporation was not the real party in interest in a lawsuit for improper disposition of collateral. The claims of Fred and Brenda Stocks that the Talbert Corporation owed them a duty to defend their corporation or themselves individually as "named insureds" under the policy, the failure of which caused them great emotional distress, cannot be sustained under the above-cited case law. The Timber Products Case has cross-claims and counterclaims that are asserted against the corporation, but nowhere are "Fred and Brenda Stocks" named as individual party defendants. Furthermore, the alleged wrongs in the Complaint are all clearly wrongs against the corporation. Count I alleges breach of duty/breach of contract by USF&G for failing to cover the corporation's fire losses; Count II alleges breach of duties/breach of contract

against Talbert for allegedly failing to procure the correct "all risk insurance policy" for the corporation; and Count III alleges breaches of covenants of good faith and fair dealing which are based on alleged wrongs against the corporation.

The Stocks have not cited a single authority that their personal guarantee of the corporation's debts alters this well settled state of the law.

In DLB Collection Trust v. Harris, supra, this court cited favorably the Colorado Appellate Court decision in Nicholson v. Ash, 800 P.2d 1352, 1354, 1355 (CO Ct. App. 1990), wherein Nicholson contended he had standing to pursue individual claims against corporate directors because of his personal guarantee of the corporate debts. The Colorado Court dismissed the claim concluding that the right of action against directors for mismanagement is one owned by the corporation itself and not individual shareholders.

The Court in Nicholson stated:

> There are several well-founded reasons why a stockholder is precluded from asserting a personal right of action against a third party whose actions have caused damage to the corporation. In such a case, it is the corporation that has suffered direct injury, and any damage resulting to the stockholder is merely indirect; such damage is normally reflected only in the decreased value of his stock. In addition, however, the rule requiring that such a claim be pursued on behalf of the corporation and for its benefit prevents a multiplicity of suits by the various stockholders and assures that the corporation will be bound by the result of the litigation. Finally, by requiring the suit to be maintained for the corporation's benefit, any proceeds resulting from the litigation will be treated as corporate assets and available to satisfy both creditors' and other stockholders' claims. *See Bell*

> *v. Arnold*, 175 Colo. 277, 487 P.2d 545 (1971). *See generally,* 12B W. Fletcher, *Cyclopedia of Law of Private Corporations* § 5910 at 418 (1984). 800 P.2d 1352,1356

The fact that a shareholder owns all, or practically all or a majority of the stock, does not of itself authorize the shareholder to sue as an individual. Fletcher, Cyclopedia of Law of Private Corporations, Vol. 12B, § 5910 at pp. 480-483 and cases cited thereunder. As a general rule, it is the corporation or stockholder in a derivative action under Rule 23.1 URCP who must pursue the claim. Richardson v. Arizona Fuels Corp., 614 P.2d 636 (Utah 1980).

In the present action, Appellants have cited no authority whatsoever that they have a private right of action for a wrong done to their corporation. Secondly, no evidence is presented that the insureds directly paid any of the legal fees or expenses in the Timber Products Case pending in the same court. They only allege that they have guaranteed corporate debt to the corporation lenders, which guarantee existed both before and after the occurrence of the forest fire. Hence, Fred and Brenda Stocks have no standing in which to pursue a wrong allegedly done to their corporation, namely the denial of indemnity and defense on the forest fire claims.

POINT II.

THERE IS NO TORT REMEDY FOR MENTAL DISTRESS ARISING OUT OF A CONTRACT DISPUTE BETWEEN OTHER PARTIES.

Pursuant to the well recognized case of Hadley v. Baxendale, 9 Ex.341, 156 Eng. Rep. 145 (1854), a plaintiff cannot recover for negligent infliction of emotional distress arising from breach of contract. See generally, 15 Personal Injury, Mathew Bender, Fright § 3.04[4] and cases cited thereunder. There are some exceptions to the general rule; however, none of the exceptions is applicable in the present action:

a. **Physical Impact Test**. A cause of action for mental distress may be pursued if there was actual direct physical contact with the complaining party. 15 Personal Injury, Mathew Bender, Fright ¶ 3.01[2], pp. 91-94. Here, there was no physical injury to any person.

b. **Zone of Danger**. Some courts have recognized that there may be an action for mental distress when there is a "near miss" or when the complaining party is arguably within the orbit of physical harm. 15 Personal Injury, Mathew Bender, Fright ¶ 3.01[3], p. 94. An example of this injury would be when an individual is changing a flat tire on the freeway and another car hits his parked vehicle killing a passenger, thereby resulting in emotional distress for the party that was not harmed but closely observed the injury.

The Utah Supreme Court in Boucher by and through Boucher v. Dixie Medical Center, 850 P.2d 1179, 1184 (Utah 1992) held that there is no recovery for parents when their son lapsed into a coma after surgery on his hand and suffered severe brain damage because the parents were not arguably within the zone of danger. In Hansen v. Sea Ray Boats, 830 P.2d 236 (Utah 1992) the Court held that recovery is possible for individuals who are victims of another's breach of duty but those outside the zone of danger may not recover for emotional distress by witnessing an injury to others. Obviously in the present case, Appellants Fred and Brenda Stocks have not suffered any physical injury but claim only emotional distress for a wrong done to a corporation in which they own stock. Therefore, there is no recognized tort remedy for mental distress for witnessing or observing an alleged breach of contract between their corporation and an insurance agent that was hired to purchase insurance.

c. **Foreseeability**. A third exception exists for actions that foreseeably could harm other parties. 15 Personal Injury, Mathew Bender, Fright ¶ 3.01[4]. This exception has never been adopted in the State of Utah. To do so, the Court would first have to make a determination that there is an independent duty flowing from the producing agent to the shareholders of the corporation. In the present action, Talbert was an independent insurance agent of USF&G and owed no "fiduciary duties" to Appellants. Talbert owes no duties to shareholders if the insurer refuses to defend or indemnify the corporation, nor is there recognizable

duty to shareholders for breach of contract to the corporation. Talbert submits the Court should not create a cause of action for many of the reasons set forth above, including: (1) it would result in a multiplicity of litigation, (2) "causation" of mental distress would be difficult to establish and hence the potential for abuse is great, and (3) the injured party really is the corporation, not the shareholders. As Professor Prosser stated:

> It would be absurd for the law to seek to secure universal peace of mind, and many interferences with it must of necessity be left to other agencies of social control. Prosser, Law of Torts, 4th ed. (1971) at p.51.

Appellants cannot cite any authority supporting their claims for mental distress arising out of a contract dispute between other parties.

POINT III.

CASE LAW DOES NOT SUPPORT APPELLANTS' CLAIM OF STANDING.

Cases cited by Appellants do not support their argument or are distinguishable on their facts. In Kennecott Corporation v. Salt Lake County, 702 P.2d 451, 453 (Ut. 1985), cited at page 8 of Appellants' Brief, the court held that Salt Lake County (a governmental entity) had standing to challenge a tax commission assessment of mining property as unconstitutional in its counterclaim against the State Tax Commission (another governmental entity). None of the parties in the present litigation is a governmental entity.

None of the parties in the present litigation has statutory authority to pursue litigation against third parties who may have injured them.

The Campbell v. State Farm case cited at page 9 of Appellants' Brief may have been implicitly overturned by Sperry v. Sperry, 381 Utah Adv Rep. 27, decided by the Supreme Court on October 29, 1999, defining when a named insured is either a "first party or a third party." In Sperry, supra, the Supreme Court noted:

> Utah law clearly limits the duty of good faith to first parties to insurance contracts. Consequently, only a first party can sue for breach of that duty. (Citations omitted.) . . . There is no duty of good faith and fair dealing imposed upon an insurer running to a third party claimant . . . seeking to recover against the company's insured. At p. 28.

Other cases listed by Appellants including Wilson v. Askew, 709 F.Supp 146 (W.D. Ark. 1989) cited at page 12 of Appellants' Brief, Mason v. Federal Deposit Insurance Corp., 888 F.Supp. 799 (S.D. Texas 1995) cited at page 13 of Appellants' Brief, Heyden v. Safeco Title Insurance Company, 498 N.W.2d 905 (Wis. Ct. App. 1993) cited at page 13 of Appellants' Brief are inapplicable. These cases are from jurisdictions outside of the State of Utah. These cases fly directly in the face of express Utah decisions holding to the contrary. For example, see this court's decision in DLB Collection Trust v. Harris, supra, at p. 597, which provides:

> The court on appeal found that the plaintiff's agreement to guarantee certain debts did not enhance his status as a stockholder, and held that the directors did not owe a fiduciary to exercise due care and prudence towards guarantors of

> corporate debt. Id. at 1357. The court therefore rejected the plaintiff's argument that his status as a guarantor gave him standing to assert an individual claim against corporate officers and directors. (Citations omitted.)

Appellants' assertion in Point II of their Brief at pages 14 and 15 that Talbert owed them a "fiduciary duty" is expressly contrary to their own allegations set forth in the Verified Complaint (R.1-12) wherein Appellants allege that Talbert at all material times was an "appointed insurance agent of USF&G" and qualified to conduct business as an independent insurance agency in the State of Utah. See paragraph 4 of the Verified Complaint and specifically paragraph 9 where Appellants allege that Talbert "while acting in the capacity of an appointed insurance agent for USF&G" . . . did something wrong. Since Talbert was an independent agent acting for USF&G only, it did not owe a "fiduciary duty" to Appellants. Any duties Talbert may have owed were owed to the client who purchased the insurance policy, namely Timber Products, Inc., the corporation, and not to the individual shareholders. Appellants have cited no authority to support their position to the contrary.

CONCLUSION

Appellants cannot bring an action in their individual capacities for a wrong done to their corporation by third persons. There is no tort action for individuals observing an alleged breach of contract to procure insurance between the other parties (namely the

corporation and the agent). The District Court's dismissal of the present action should be affirmed in all respects.

RESPECTFULLY SUBMITTED this 17 day of December 1999.

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CERTIFICATE OF MAILING

I hereby certify that I mailed two (2) true and correct copies of the foregoing BRIEF OF APPELLEE - THE TALBERT CORPORATION, this 17 day of December, 1999, *postage prepaid, to the following:*

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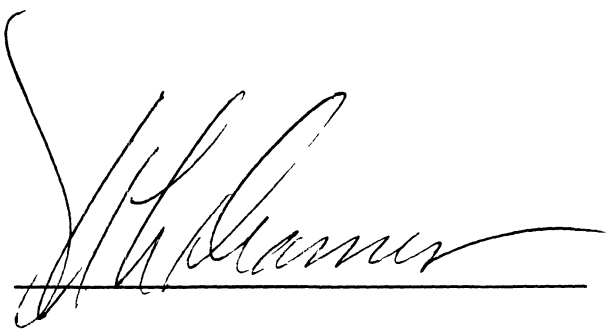

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